



*Andrew Junkin
CFA, CIMA, CAIA
Managing Director*

March 24, 2009

Mr. Joseph Dear
Chief Investment Officer
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Policy Revisions for Fixed Income

Dear Joe:

You requested Wilshire's opinion with respect to the proposed revisions to the Statement of Investment Policy for Global Fixed Income (the "GFI Policy") and the Statement of Investment Policy for the Barclays Aggregate Program (the "Aggregate Policy"). Staff is proposing to clarify language to allow for investment in non-investment grade bonds in non-US, non-emerging market countries.

Recommendation

Wilshire recommends that the Policy Subcommittee adopt the revised policies as presented. This will allow CalPERS' high yield managers to invest opportunistically in non-investment grade debt across the globe, without subjecting the capital to the additional risks posed by investing in corporate debt in emerging markets. However, in our opinion, Staff should constrain the amount of non-USD high yield debt that managers may purchase to a reasonable amount through the manager's guidelines.

Background

As the credit crisis has affected global markets, there are significant opportunities in high yield markets, both domestically and abroad. However, the bulk of the opportunity set is in the US. By way of comparison, the size of the US long duration investment grade universe (which is the universe of investable securities for the bulk of CalPERS fixed income portfolio) is approximately \$1.4 trillion, the size of the US non-investment grade market (both bonds and loans) is approximately \$1 trillion, and the size of the pan-European non-investment grade market is approximately \$61 billion (€48 billion)(note that Barclays breaks global high yield assets into US, emerging and pan-European only). As such, CalPERS' high yield managers are unlikely to invest significantly in non-US

Policy Revisions for Fixed Income
March 24, 2009
Page 2

markets. However, broadening the universe slightly gives the managers more flexibility in helping CalPERS achieve its investment goals.

Staff should constrain the amount of non-USD high yield debt that a manager can purchase so that managers can only use it opportunistically. Non-USD debt clearly brings currency risk to the table, so the opportunity to use non-USD high yield debt should be limited to those managers where Staff believes the manager has sufficient resources to evaluate and, if appropriate, mitigate the currency risk.

Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,

A handwritten signature in black ink, appearing to read "Ann Jinn". The signature is fluid and cursive, with a large loop at the end.